ACPM/ACARR
The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

Pension Investment Association of Canada
Association Canadienne des gestionnaires de fonds de retraite

August 10, 2004

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- and -

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Dear Sirs/Mesdames

Re: ***CSA Notice 81-405 – Request for Comment on Proposed Exemptions for Certain Capital Accumulation Plans***

The Association of Canadian Pension Management (ACPM) and the Pension Investment Association of Canada (PIAC) are pleased to jointly provide comments to the members of the Canadian securities administrators (CSA) on the proposed exemptions for certain capital accumulation plans (CAPs) published for comment by CSA Notice 81-405 on May 28, 2004.

ACPM and PIAC have been active participants throughout the past few years in the work to develop the Guidelines for Capital Accumulation Plans released by the Joint Forum of Financial Market Regulators on May 28. We are pleased that the Guidelines have been released in final form and reflect many of the views we have expressed over the years. We are also very pleased that the CSA have released the proposed exemptions for comment—the proposed exemptions are essential for the proper administration and implementation of the final Guidelines by industry participants.

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Overall we support the work of the CSA, along with the other members of the Joint Forum of Financial Market Regulators, to promote a nationally harmonized regime for CAP sponsors, administrators and service providers, including managers of mutual funds that are investment choices for CAP participants. We believe that the final Guidelines for CAPs issued by the Joint Forum, when combined with the proposed CSA exemptions, will serve to clarify the obligations of CAP market participants and will result in more complete and consistent investor protection for participants in CAPs.

We have elected to provide our comments in the form of the attached memorandum and hope that the CSA will find our comments to be constructive.

We thank you again for the opportunity to work with you on this important initiative. We look forward to continuing to work with the CSA in finalizing the exemptions which are essential to the proper implementation of the final Guidelines.

Yours truly,

Stephen Bigsby, Executive Director

Association of Canadian Pension Management

Keith Douglas, General Manager

Pension Investment Association of Canada

Our comments on the proposed exemptions reinforce the fundamental principle for the regulation of CAPs that we urge the CSA to keep in mind. The regulation of CAPs must be harmonized across Canada and across industry sectors. It is essential that industry participants be able to easily understand the rules that apply to them. Those rules must be the same whether those industry participants and the participants in CAPs, are based in British Columbia, in Ontario, in Quebec or in any other province or territory in Canada. Similarly, the rules and the regulatory burden on industry participants should be the same whether the investment choices in a CAP are public mutual funds, pooled funds (that is, exempt mutual funds), segregated funds, GICs or any other type of security or investment product. By keeping the rules harmonized in these circumstances, participants in CAPs will have the same investor protection without regard to investment choice and province of residence.

Form of the Proposed Exemptions

1. As a preliminary matter, we wish to comment on the form the proposed exemptions will take in the various provinces and territories. In the CSA Notice, you state "In *most* provinces, we expect to adopt the proposed exemption in the form of a blanket exemption from the dealer registration and the prospectus requirements for certain trades in mutual fund securities". You then note that since the Ontario Securities Commission does not have authority to grant blanket exemptions, that market participants will still have to apply for exemptions in Ontario. You also note that the CSA is working on a national exemption rule and that you contemplate that *at some point* the proposed exemptions *might* be incorporated into that national instrument.

   We urge all members of the CSA to move towards a nationally uniform exemption. If the most expeditious way of accomplishing this objective in provinces that do not have the ability to grant blanket exemptions is to publish for comment a draft rule that is the same as the blanket exemptions granted in the other provinces and territories, we strongly recommend this be done. It will be most inefficient for industry participants to make applications for the expected relief and we wish to note our objections to this procedure proposed for Ontario market participants. We also strongly recommend that the CSA include this exemption in the anticipated national exemptions rule.

   If the OSC (and the other applicable provinces without the authority to grant blanket exemptions) does not publish a draft rule in the form of the proposed exemption, we encourage the OSC to explain which CAP participant the OSC expects to make the application—who does the OSC consider caught by the prospectus requirements (ie. the mutual funds, being the investment choices in the CAP? the CAP administrator? the CAP sponsor?) and the dealer requirements (ie. the CAP administrator? the CAP sponsor?). How will the application fees be levied? Can more than one issuer/CAP administrator/CAP sponsor apply in one application for identical relief?

Additional exemptions are needed to achieve full harmonization across Canada

2. In the CSA Notice, you note that in *some* CSA jurisdictions the information that is given to CAP participants *may* constitute an offering memorandum. You explain the situation under the laws of Saskatchewan and Nova Scotia, but do not provide conclusive views on the effect of these laws in that you use words such as "may constitute", "likely constitute" and "such as". It would be useful to understand definitively if other provinces will take similar positions in light of their regulation. For the reasons we provide below, we strongly recommend that the proposed exemption provide an additional exemption from all provincial/territorial legislation that may have this effect.

In our view as we outline above, it would be an inappropriate result for CAP participants in certain provinces to have different rights from the CAP participants in other provinces. Equally importantly, we submit that the Final Guidelines have been drafted on the premise and fully recognizing that traditional securities legislation and principles fit awkwardly with the relationships between CAP sponsors, CAP administrators, CAP participants and the issuers, together with the managers of those issuers, that are investment choices for CAPs.

The CAP participant does not rely on the information that is provided by the mutual funds or their managers in making an investment choice. The CAP participant is relying on the information being provided to him or her by the CAP administrator or sponsor. For the most part, the CAP administrator or sponsor picks appropriate investment choices and provides participants with the information contemplated in the Final Guidelines. In many cases, the investment choices are limited to a defined menu of choices. The CAP administrator or sponsor arranges for the investment choices, with the applicable mutual funds and their managers, asking for information from those entities, which it then packages appropriately to provide to the CAP participants. The mutual funds and their managers have an obligation, at law and also, in some cases, by contract with the CAP sponsor or administrator to provide accurate information to that entity. But the mutual funds and their managers do not provide information directly to the CAP participants, particularly since much of the contents of a conventional simplified prospectus would not apply to the circumstances that apply to the CAP participant.

The traditional securities legal analysis of a "chain" of responsibility between the mutual funds (as issuers of securities) and the ultimate investor (the CAP participant), in this way, has been broken. It would be inappropriate for securities legislation to contemplate any rights against the mutual funds directly by the CAP participant. Similarly, it is equally inappropriate for securities legislation to somehow apply to the CAP and deem it, or its sponsor, as akin to an "issuer" of securities. The CAP participant would have rights against the CAP administrator or sponsor, depending on the terms of the CAP and the relationships formed at law. In our view, the Final Guidelines are consistent with and substantiate this analysis.

We believe that the second question posed in the Notice is based on a traditional securities legal analysis, which we submit does not apply to the relationships formed with CAPs. You ask whether CAP participants should have recourse against an issuer of a security, which would mean the mutual funds (since the mutual funds are the only permitted issuers) and whether CAP participants should be given rights of withdrawal similar to those that apply when an investor purchases securities directly from those funds. Again, we submit that the traditional securities analysis does not apply to CAP relationships, which are significantly different from the traditional securities relationships.

In our view, granting the prospectus and dealer exemptions, along with the exemptions from any regulation dealing with offering memoranda, does not reduce investor protection for the CAP participants, particularly given the Final Guidelines and the CAP relationships at law.

Existing exemptions should be incorporated in the proposed exemptions

3. In order to achieve the overall harmonization goals we outline above, we recommend that the Alberta and Ontario securities commissions re-consider the existing exemptions provided by way of existing local rule and, unless there is a compelling reason to retain them in a separate rule, incorporate any provisions that are important to existing relationships into the proposed exemption. The Notice describes, without additional explanation, that the Alberta Commission is inclined to revoke its local rule, but that the Ontario Commission "expects to retain" its existing exemption, being OSC Rule 32-503 *Registration and Prospectus Exemption for Trades by Financial Intermediaries in Mutual Fund Securities to Corporate Sponsored Plans.*

   In our view, the Final Guidelines, when coupled with the proposed exemption, will serve to achieve the harmonization goals we believe are essential. It is not clear to us, whether a CAP that falls within the restricted confines of the existing Ontario rule, for example, would be required by law to follow the Final Guidelines. The exemptions provided in that rule do not have the same conditions as those proposed under the proposed exemptions. We believe that some industry participants may be legitimately relying on the Alberta and Ontario rules and submit that these exemptions should be incorporated into the proposed exemptions (to the extent they are not covered by the proposed exemptions) and made to apply on a national basis, so that the regime that applies to CAPs can be found in one place.

Comments on specific provisions of the proposed exemption

4. As a preliminary drafting matter, since the proposed exemptions will be used by industry participants who may not be familiar with terminology used by the CSA and defined in securities legislation, we recommend that the term "mutual fund" be explained in a companion policy to the proposed exemption. Readers of the proposed exemption should understand that the term "mutual fund" includes both publicly offered mutual funds, and also exempt mutual funds, which are more commonly referred to as "pooled funds".

5. It is not clear to us whether the CSA intend for the conditions to the prospectus and the registration exemptions to be identical to the expectations for CAP sponsors and administrators contained in the Final Guidelines. For example, are the conditions set forth in subsection 2.1(b) and (c) the same as, or in addition to, the provisions in the Final Guidelines? In our view, the proposed exemptions should link back to the Final Guidelines and should not add any new requirement from those contained in the Final Guidelines. Our overriding recommendation is that regulation of CAPs be harmonized—across Canada and across industry sectors. The fact that mutual funds are investment options should not give rise to additional requirements for CAP industry participants. We recommend that the proposed exemption refer to the Final Guidelines, without repeating the provisions. This will allow for the proposed exemption to stay in step with any changes to the Final Guidelines.

   If the CSA do not take the above approach, we recommend that any differences be explained and industry participants be given an opportunity to understand why the CSA is proposing different requirements when mutual funds are investment options under CAPs.

6. If the existing conditions are retained, we have the following comments on those conditions and on the other provisions in the proposed exemption.

Section 2.1

(a) Paragraphs (c) (iii) and (iv) use terminology that is different from current CSA regulation of investment funds. We recommend that (iii) be amended to refer to the fundamental investment objective of the mutual fund and that (iv) be amended to refer to the investment strategies of the mutual fund.

(b) Is the information contemplated to be provided by the plan sponsor under section 2.1, to be in writing? When is this information to be provided? In advance of making an investment choice?

(c) Paragraph (e) could more usefully refer back to the rules relating to calculation of performance by mutual funds contained in NI 81-102. The conditions currently contained in paragraph (e) are less precise than in NI 81-102 and we recommend uniformity in this regard.

(d) Paragraph (f) refers to "changes" in the mutual fund. What kind of changes? As you know, public mutual funds must disclose all "material" or "significant" changes (both those terms are defined under securities regulation) and cannot make "fundamental" changes without securityholder input. What is contemplated in paragraph (f)? We recommend further precision and clarity, given the rules that apply to public mutual funds.

(e) Paragraph (g) refers to "decision-making tools". Are these intended to be different from those discussed in the Final Guidelines?

Section 2.2

(f) Section 2.2 is adequate, as drafted (although we believe the requirement to give contact information to CAP participants is somewhat self-evident in the circumstances), however we recommend that it is equally important that CAP participants be given information about any fees that the registrant will charge to the CAP participants, any payments that are going to the registrant from the CAP sponsor or administrator or the mutual funds and their managers, together with any relationships between the CAP sponsor or administrator, the mutual funds and their managers and the registrant.

Section 2.3

(g) As a drafting matter, we believe the phrase "the prospectus requirement does not apply to a distribution of a security of a mutual fund *that complies with the conditions set out in section 2.1*" needs additional clarity. We are unsure if you mean that the distribution complies or if you mean that the mutual fund complies (which cannot be the correct interpretation, since the conditions in section 2.1 do not impose obligations on the mutual fund). We believe that this sentence should be redrafted to state "the prospectus requirement does not apply to a distribution of a security of a mutual fund, if in respect of each trade, the conditions set out in section 2.1 have been complied with."

(h) Paragraph (i) imposes a requirement that the applicable mutual funds must comply with the investment restrictions in NI 81-102. We point out that the Final Guidelines contemplate that when investment funds are offered in a CAP that is a registered pension plan, that the funds must comply with the investment rules under applicable pension benefits standards legislation. The Final Guidelines also confirm that mutual funds must

comply with NI 81-102. In our view, the Final Guidelines are ambiguous, since it may not be possible for a mutual fund (generally a pooled fund) that is an investment option under a registered pension plan to comply with both pension investment restrictions and NI 81-102, since the investment restrictions and practices are not completely compatible or harmonized in several important areas. We submit that the CSA should resolve this ambiguity, by providing that a mutual fund (including a pooled fund) that is an investment option under a CAP that is a registered pension plan must comply with applicable pension investment restrictions and practices, without also having to comply with NI 81-102. Mutual funds (including pooled funds) that are investment options in any other form of CAP must comply with NI 81-102.

(i) As a drafting matter, we also recommend that paragraph (i) refer to the restrictions on investments and investment practices set out in NI 81-102, to clarify that you intend for mutual funds, when used as investment options in CAPs that are not registered pension plans (see our comment (h) above), to comply with all of Part 2 of NI 81-102.

(j) As a drafting matter, we find the use of the word "advised" in paragraph (ii) to be a somewhat imprecise usage. As you know, in order for mutual funds to operate (unless they are internally managed), they must have a registered portfolio manager or engage an entity that is exempt from registration to provide that service. Also what is intended by the words "in whole or in part"? We recommend this provision be deleted, since it does not add anything that is not already required by securities laws, unless the CSA wishes to ban internally managed funds, in which case, this should be stated more directly.

Section 3.1

(k) We recommend that this section be deleted as unnecessary regulation. This provision is more in keeping with traditional securities law analysis and relationships, when the members of the CSA wish to be able to identify and monitor exempt market purchases and to allow the public to monitor exempt market distributions by business corporations. As we have outlined, we believe that CAPs do not give rise to traditional relationships and accordingly, we see no need or benefit for CSA members keeping track of CAP participants' investments in mutual funds nor do we see any necessity for public tracking of these distributions. It may be that securities regulation in some provinces requires that these reports be filed (but likely on a trade-by-trade basis). If this is the case, we recommend that the proposed exemption be amended to provide a complete exemption from the trade reporting requirements, including payment of applicable exempt distribution fees.

We point out that insurance products used as investment options would not be subject to a similar regulatory burden and without a complete exemption, CAPs using mutual funds as investment options would be subject to an extra regulatory burden. If this provision is retained, we would appreciate understanding what benefit the CSA see in retaining it, compared against the compliance costs to CAP participants and industry participants.

If this provision is retained, we urge the CSA to recognize CAP relationships and put the obligation to file the reports on the CAP administrator or sponsor, and not on the mutual funds. In any event, given the national scope of many CAPs, it is often very difficult for mutual funds to know in which provinces it must file these reports based on the province/territory of residence of the CAP participants.

Responses to questions asked in CSA Notice

The CSA ask two questions in the CSA Notice.

In response to the first question, we submit that it would be more useful for CAP participants to receive a breakdown of fees and expenses in most cases, rather than an aggregated number. However, as we point out above in paragraph 5, we believe that the proposed exemption should refer to the Final Guidelines and not impose different and, certainly not more onerous requirements than those suggested in the Final Guidelines.

We have largely addressed the second question in paragraph 2 above. However, we wish to emphasize that, in our view, the CSA should not deem, or look upon the CAP as an issuer of securities. Rather, a CAP, as is recognized in the Final Guidelines, is the same as other registered tax plans, such as RRSPs and as such is not a separate "security" or "issuer". CAP participants do not receive an "interest" in a CAP. They invest directly in the securities [or otherwise] of the investment options chosen by them.